

period costs which are currently deductible. This method is commonly referred to as the "direct cost" method.

(7) Treating all or substantially all indirect production costs (whether classified as fixed or variable) as period costs which are currently deductible. This method is generally referred to as the "prime cost" method.

[T.D. 6500, 25 FR 11724, Nov. 26, 1960, as amended by T.D. 7285, 38 FR 26185, Sept. 19, 1973]

#### § 1.471-3 Inventories at cost.

Cost means:

(a) In the case of merchandise on hand at the beginning of the taxable year, the inventory price of such goods.

(b) In the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods. For taxpayers acquiring merchandise for resale that are subject to the provisions of section 263A, see §§ 1.263A-1 and 1.263A-3 for additional amounts that must be included in inventory costs.

(c) In the case of merchandise produced by the taxpayer since the beginning of the taxable year, (1) the cost of raw materials and supplies entering into or consumed in connection with the product, (2) expenditures for direct labor, and (3) indirect production costs incident to and necessary for the production of the particular article, including in such indirect production costs an appropriate portion of management expenses, but not including any cost of selling or return on capital, whether by way of interest or profit. See §§ 1.263A-1 and 1.263A-2 for more specific rules regarding the treatment of production costs.

(d) In any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the

particular industry. Among such cases are:

(1) Farmers and raisers of livestock (see § 1.471-6);

(2) Miners and manufacturers who by a single process or uniform series of processes derive a product of two or more kinds, sizes, or grades, the unit cost of which is substantially alike (see § 1.471-7); and

(3) Retail merchants who use what is known as the "retail method" in ascertaining approximate cost (see § 1.471-8).

Notwithstanding the other rules of this section, cost shall not include an amount which is of a type for which a deduction would be disallowed under section 162 (c), (f), or (g) and the regulations thereunder in the case of a business expense.

[T.D. 6500, 25 FR 11725, Nov. 26, 1960, as amended by T.D. 7285, 38 FR 26185, Sept. 19, 1973; T.D. 7345, 40 FR 7439, Feb. 20, 1975; T.D. 8131, 52 FR 10084, Mar. 30, 1987; T.D. 8482, 58 FR 42233, Aug. 9, 1993]

#### § 1.471-4 Inventories at cost or market, whichever is lower.

(a) *In general*—(1) *Market definition*. Under ordinary circumstances and for normal goods in an inventory, *market* means the aggregate of the current bid prices prevailing at the date of the inventory of the basic elements of cost reflected in inventories of goods purchased and on hand, goods in process of manufacture, and finished manufactured goods on hand. The basic elements of cost include direct materials, direct labor, and indirect costs required to be included in inventories by the taxpayer (e.g., under section 263A and its underlying regulations for taxpayers subject to that section). For taxpayers to which section 263A applies, for example, the basic elements of cost must reflect all direct costs and all indirect costs properly allocable to goods on hand at the inventory date at the current bid price of those costs, including but not limited to the cost of purchasing, handling, and storage activities conducted by the taxpayer, both prior to and subsequent to acquisition or production of the goods. The determination of the current bid price of the basic elements of costs reflected in goods on hand at the inventory date